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**AUDITOR-GENERAL  
SOUTH AFRICA**

# **Mnquma Municipality**

## **Audit Report**

For the year ended 30 June 2013

# REPORT OF THE AUDITOR-GENERAL TO THE EASTERN CAPE PROVINCIAL LEGISLATURE AND THE COUNCIL ON MNQUMA LOCAL MUNICIPALITY

## REPORT ON THE FINANCIAL STATEMENTS

### Introduction

1. I have audited the financial statements of the Mquma Local Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2013, the statement of financial performance, statement of changes in net assets, the cash flow statement and statement of comparison of budget and actual amounts for the year then ended, and the notes, comprising a summary of significant accounting policies and other explanatory information.

### Accounting Officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with South African Standards of Generally Recognised Accounting Practices (Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act no.56 of 2003) (MFMA), and the Division of Revenue Act of South Africa, 2013 (Act No.2 of 2013) (DORA), and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

### Auditor-General's responsibility

3. My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), the *General Notice* issued in terms thereof and International Standards on Auditing. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
4. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.
5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified audit opinion.

### Basis for qualified opinion

#### Investment property

6. The municipality did not recognise all the properties for which it has title and thus did not meet the recognition requirements of GRAP 16: *Investment property*. As a result, investment property and accumulated surplus are understated by R19 million.

#### Property, plant and equipment

7. The municipality did not have adequate controls, including reconciliations and asset counts, in order to maintain a complete and accurate asset register. Movable assets

could not be traced to and from the register and title to buildings could not be confirmed. Consequently, property, plant and equipment is understated by R13,8 million and overstated by R9,8 million. The net impact is an understatement of property, plant and equipment of R4 million and understatement of depreciation, accumulated surplus and VAT Receivable of R392 923, R3,9 million and R327 294 respectively. In addition, the asset register contained several fully depreciated assets that are still in use and are necessary to service delivery. Management did not perform an assessment of carrying values, useful lives and residual values as required by GRAP 17: *Property, plant and equipment*. It was thus impracticable for me to determine the full extent of the understatement in property plant and equipment. Consequently, I was unable to determine whether any further adjustments were necessary to property, plant and equipment of R247,3 million, as disclosed in note 5 to the financial statements.

#### **Depreciation**

8. GRAP 17: *Property, plant and equipment* requires the useful lives of an asset to be reviewed at least at each reporting date. The asset register included several fully depreciated assets. Due to management not performing an assessment of the useful lives of these assets, it was impracticable for me to determine the full extent of the misstatement in depreciation of R34,6 million that is disclosed in note 30 to the financial statements. I was unable to confirm the amount by alternative means. Consequently, I was unable to confirm whether any further adjustments relating to depreciation were necessary in the financial statements.

#### **Irregular expenditure**

9. The municipality did not have adequate systems in place to identify and disclose all irregular expenditure incurred during the year as required by section 125(2)(d)(i) of the MFMA. Over and above the irregular expenditure of R53,8 million in note 45 to the financial statements, additional amounts totalling R20,7 million were detected during the audit process. This irregular expenditure was neither detected nor disclosed in the financial statements. As a consequence irregular expenditure is understated by R20,7 million in note 45. In addition the municipality does not have adequate systems to review its financials and the current year disclosure is further overstated by R4 million (2012: understated by R4,3 million), and the closing balance disclosed is understated by R299 864 due to errors made in the preparation of the financials. Sufficient appropriate audit evidence was not available to support irregular expenditure of R1,1 disclosed in note 45 to the financial statements. Consequently, I was unable to determine whether any further adjustments were necessary.

#### **Cash flow statement and cash generated from operations note comparative**

10. The municipality could not provide an adequate reconciliation for the cash flow statement and note 34. Sufficient appropriate audit evidence was also not available to support the calculations for other cash item included in cash flows from operating activities in the cash flow statement and prior period asset corrections included in the cash generated from operations note. I was unable to confirm these by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to cash flows from financing activities of R17,3 million and adjustments for the prior period asset correction of R18,8 million disclosed in note 34 to the financial statements.

#### **Expenditure**

11. Sufficient appropriate audit evidence was not available to support repairs and maintenance of R10,5 million and general expenditure of R5,9 million. I was unable to confirm the expenditure by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to repairs and maintenance expenditure of R28,2 million disclosed in the statement of financial performance and

general expenditure of R57 million disclosed in note 25 to the financial statements.

#### **Inventory**

12. There was inventory on hand at year end, according to the report from the municipal inventory system. Inventory has not been disclosed in the statement of financial position or the notes there to. The municipality did not maintain an adequate inventory system and documentation to support the quantity and price of the inventory on hand was not submitted by the municipality. Consequently I was unable to determine whether disclosure of, and adjustments to inventory, were necessary.

#### **Statement of comparison of budget and actual amounts**

13. The municipality did not include all the required reasons for variances and reasons provided where not always sufficient or supported by evidence as required by GRAP 24: *Presentation of Budget Information in the Financial Statements*.

#### **Aggregation of immaterial uncorrected misstatements**

14. The financial statements as a whole are materially misstated due to the cumulative effect of numerous individually immaterial uncorrected misstatements in the following elements making up the statement of financial position in the current and prior year and the statement of financial performance in the prior year:
- General expenses as disclosed in note 25 to the financial statements is understated by R1.6 million in the prior year.
  - Repairs and maintenance disclosed in the statement of financial performance is understated in the prior year by R5,7 million.
  - Accumulated surplus as disclosed in the statement of financial position is overstated by R4 million.
  - Unspent conditional grants as disclosed in note 15 to the financial statements is overstated by R1,1 million.
  - Trade receivables from exchange transactions as disclosed in note 10 to the financial statements is understated by R3,5 million (2012: R201 973).
  - Trade receivables from non-exchange transactions disclosed in note 11 is understated by R2,2 million.
  - Property, plant and equipment as disclosed in note 5 in the prior year is overstated by R5,1 million.
15. In addition, I was unable to obtain sufficient appropriate audit evidence due to individually immaterial amounts that were unsubstantiated and I was unable to confirm the following elements by alternative means.
- Property, plant and equipment as disclosed in note 5 to the financial statements in the prior year;
  - Trade receivables from exchange transactions in note 10 to the financial statements in the prior year;
  - General expenditure in note 25 to the financial statements in the prior year; and
  - Repairs and maintenance in the prior year statement of financial performance.

#### **Qualified opinion**

16. In my opinion, except for the effects of the matters described in the basis for qualified opinion paragraphs the financial statements present fairly, in all material respects, the financial position of the Mnquma Local Municipality as at 30 June 2013, and its financial performance and cash flows for the year then ended in accordance with Standards of GRAP, the requirements of the MFMA and DORA.

#### **Emphasis of matters**

17. I draw attention to the matters below. My opinion is not modified in respect of these



matters.

#### **Restatement of corresponding figures**

18. As disclosed in note 2 and 38 to the financial statements, the corresponding figures have been restated as a result of errors only corrected during the year ended 30 June 2012 that existed in the financial statements at, and for the year ended, 30 June 2012.

#### **Material impairments**

19. As disclosed in note 10 and 11 to the financial statements, an amount of R86,9 million (2012: R84,9 million) has been impaired as a result of a non-payment of consumer debtor accounts.

#### **REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS**

20. In accordance with the PAA and the *General Notice* issued in terms thereof, I report the following findings relevant to performance against predetermined objectives, compliance with laws and regulations and internal control, but not for the purpose of expressing an opinion.

#### **Predetermined objectives**

21. I performed procedures to obtain evidence about the usefulness and reliability of the information in the annual performance report as set out on pages ... to ... of the annual report.
22. The reported performance against predetermined objectives was evaluated against the overall criteria of usefulness and reliability. The usefulness of information in the annual performance report relates to whether it is presented in accordance with the National Treasury's annual reporting principles and whether the reported performance is consistent with the planned objectives. The usefulness of information further relates to whether indicators and targets are measurable (i.e. well defined, verifiable, specific, measurable and time bound) and relevant as required by the *National Treasury Framework for managing programme performance information*.

The reliability of the information in respect of the selected objectives is assessed to determine whether it adequately reflects the facts (i.e. whether it is valid, accurate and complete).

23. The material findings are as follows:

#### **Usefulness of information**

##### **Measures taken to improve performance not disclosed**

24. Section 46 of the Municipal Systems Act, 2000 (Act No.32 of 2000) (MSA) requires disclosure in the annual performance report of measures taken to improve performance where planned targets were not achieved. Measures to improve performance for a total of 69% of the planned targets not achieved were not reflected in the annual performance report. This was due to the lack of documented and approved internal policies and procedures to address reporting requirements.

#### **Consistency**

##### **Reported objectives not consistent with planned objectives**

25. The MSA, section 41(c) requires that the integrated development plan should form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. A total of 67% of the reported objectives, 59% of reported indicators and 22% of reported targets are not consistent with the objectives as per the approved integrated development plan and the service

delivery budget implementation plan. This was due to changes being made to objectives and indicators subsequent to the approval of the integrated development plan and the service delivery budget implementation plan and not being approved.

26. The MSA, section 41(c) requires that the actual achievements against all planned indicators and targets must be reported annually. The annual performance report submitted for audit purposes did not include the actual performance of 53% of all planned objectives specified in the service delivery budget implementation plan for the year under review. This was due to the lack of or limited review and monitoring of the completeness of reporting documents by management.

### **Measurability**

#### **Performance Indicators not well defined**

27. The National Treasury *Framework for managing programme performance information (FMPPI)* requires that indicators should have clear unambiguous data definitions so that data is collected consistently and is easy to understand and use. A total of 33% of the indicators were not well defined in that clear, unambiguous data definitions were not available to allow for data to be collected consistently. This was due to the fact that management was aware of the requirements of the FMPPI but did not receive the necessary training to enable application of the principles.

#### **Indicators not verifiable**

28. The FMPPI requires that it must be possible to validate the processes and systems that produce the indicator. A total of 70% of the indicators were not verifiable in that valid processes and systems that produce the information on actual performance did not exist. This was due to the lack of documented key controls in the relevant systems of collection, collation, verification, storage of actual performance information. Furthermore, management was aware of the requirements of the FMPPI but did not receive the necessary training to enable application of the principles.

#### **Performance targets not specific**

29. The FMPPI requires that performance targets be specific in clearly identifying the nature and required level of performance. A total of 41% of the targets were not specific in clearly identifying the nature and the required level of performance. This was due to the fact that management was aware of the requirements of the FMPPI but did not receive the necessary training to enable application of the principles.

#### **Performance targets not measurable**

30. The FMPPI requires that performance targets be measurable. The required performance could not be measured for a total of 56% of the targets. This was due to the fact that management was aware of the requirements of the FMPPI but did not receive the necessary training to enable application of the principles.

### **Reliability of information**

31. The FMPPI requires that institutions should have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets.
32. The information presented with respect to Service Delivery and Infrastructure Development was not reliable when compared to the source information and/or evidence provided.
33. This was due to the lack of standard operating procedures for the accurate recording of actual achievements and monitoring of the completeness of source documentation in support of actual achievements and frequent review of validity of reported achievements



against source documentation.

#### **Compliance with laws and regulations**

34. I performed procedures to obtain evidence that the entity has complied with applicable laws and regulations regarding financial matters, financial management and other related matters. My findings on material non-compliance with specific matters in key applicable laws and regulations as set out in the *General Notice* issued in terms of the PAA are as follows:

#### **Expenditure**

35. Money owing by the municipality was not always paid within 30 days or an agreed period, as required by section 65(2)(e) of the MFMA.
36. Reasonable steps were not taken to prevent unauthorised expenditure and irregular expenditure, as required by section 62(1)(d) of the MFMA.

#### **Budgets**

37. Expenditure was incurred not in terms of the approved budget, in contravention of section 15 of the MFMA.

#### **Annual financial statements and annual report**

38. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA.
39. Material misstatements of non-current assets, current assets, liabilities, expenditure and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected and/or the supporting records were provided subsequently, but the uncorrected material misstatements and/ or supporting records that could not be provided resulted in the financial statements receiving a qualified audit opinion.
40. The 2011/12 annual report was not:
- tabled in the municipal council within seven months after the end of the financial year, as required by section 127(2) of the MFMA.
  - made public immediately after the annual report was tabled in the council, as required by section 127(5)(a) of the MFMA.
41. An oversight report, containing comments on the annual report, was not adopted by council within two months from the date on which the 2011/12 annual report was tabled, as required by section 129(1) of the MFMA.
42. The council's oversight report on the 2011/12 annual report was not made public within seven days of its adoption, as required by section 129(3) of the MFMA.

#### **Revenue management**

43. Accounts for municipal tax and charges for municipal services or service charges were not prepared on a monthly basis, as required by section 64(2)(c) of the MFMA.

#### **Conditional grants**

44. The municipality did not:
- evaluate its performance in respect of programmes funded by the Municipal Infrastructure Grant or submit the evaluation to the transferring national officer within two months after the end of the financial year, as required by section 12(5) of the Division of Revenue Act, 2013 (Act no.2 of 2013) (DORA),
  - timeously submit project registration forms, for projects it intends implementing in the financial year 2013/14, to the department of local government, as required by the

DORA Grant Framework, Gazette No.35399 (DORA Framework),

- evaluate its performance in respect of programmes funded by the Integrated National Electrification Programme or submit the evaluation to the transferring national officer within two months after the end of the financial year, as required by section 12(5) of the DORA,
- register its master plans for bulk infrastructure with the Integrated National Electrification Programme, as required by the DORA Framework.

45. Projects funded by the Integrated National electrification Programme grant were not implemented in line with the details contained in the Integrated Development Plan, as required by the DORA Framework.
46. Sufficient appropriate audit evidence could not be obtained that the allocation for the Municipal Systems Improvement and Local Government Financial Management Grant was utilised for purposes other than those stipulated in the grant framework, in contravention of section 16(1) of the DORA.
47. The municipality did not evaluate its performance of programmes funded by the Municipal Systems Improvement Grant or submit the evaluation to the transferring national officer within two months after the end of the financial year, as required by section 12(5) of the DORA.

#### **Asset management**

48. An effective system of internal control for assets (including an asset register) was not in place, as required by section 63(2)(c) of the MFMA.

#### **Performance management**

49. The performance management system of the municipality did not provide for the taking of steps to improve performance with regard to those development priorities and objectives where performance targets are not met, as required by section 41 (1)(d) of the MSA.
50. The municipality did not establish mechanisms to monitor and review its performance management system, as required by section 40 of the MSA.
51. The annual performance report for the year under review does not include measures taken to improve performance, as required by section 46 (1)(b) of the MSA.

#### **Human Resource Management**

52. The performance agreements of the municipal manager, chief financial officer (CFO) and head of supply chain who did not have the minimum competencies, did not include the attainment of minimum competencies as a performance target, as required by Municipal Regulations on Minimum Competency Levels Regulation (MRMCLR) 16(2).
53. The performance agreements of the financial official who did not have the minimum competencies, did not include the attainment of minimum competencies as a performance target, as required by MRMCLR 16(1).
54. The CFO was appointed without having met the prescribed minimum competency levels and the continued employment in the position was not made subject to meeting such requirements by 1 January 2013, as required by section 56(1)(b) of the MSA and regulation 18(2) on Minimum Competency Levels.
55. A senior manager directly accountable to the municipal manager was appointed without the approval of the municipal council, in contravention of section 56(1)(a) of the MSA.

56. An approved staff establishment was not in place, as required by section 66(1)(a) of the MSA.
57. The competencies of financial and supply chain management officials were not assessed in a timely manner in order to identify and address gaps in competency levels as required by the MRMCLR 13.
58. The municipality did not submit a report on compliance with prescribed competency levels to the National Treasury and relevant provincial treasury as required by the MRMCLR 14(2)(a).
59. The annual report of the municipality did not reflect information on compliance with prescribed minimum competencies as required by the MRMCLR 14(2)(b).
60. The accounting officer did not meet any of the prescribed competency areas as required by sec 83 of the MFMA and regulation 2 and 3 of the MRMCLR.
61. The CFO did not have the higher education qualification or meet any of the prescribed competency areas as required by section 83 of the MFMA and regulation 4 and 5 of the MRMCLR.
62. The head of supply chain management did not have the higher education qualification or meet any of the prescribed competency areas as required by sec 119 of the MFMA and regulation 10 and 11 of the MRMCLR.
63. All senior managers did not meet any of the prescribed competency areas as required by regulation 6 and 7 of the MRMCLR.
64. Finance officials at middle management and supply chain management managers did not have the higher education qualification or any of the prescribed competency areas as required by regulation 8 and 9 of the MRMCLR.

#### **Procurement**

65. Goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations as required by Supply Chain Management (SCM) regulation 17(a) & (c).
66. Contracts and quotations were awarded to bidders based on points given for criteria that differed from those stipulated in the original invitation for bidding and quotations, in contravention of SCM Regulations 21(b) and 28(1)(a) and the Preferential Procurement Regulations.
67. Bid adjudication was not always done by committees which were composed in accordance with SCM regulation 29(2).
68. The preference point system was not applied in all procurement of goods and services above R30 000 as required by section 2(a) of the Preferential Procurement Policy Framework Act, 2000 (Act No.5 of 2000) (PPPFA) and SCM regulation 28(1)(a).
69. Contracts were extended without tabling the reasons for the proposed amendment in the council of the municipality, as required by section 116(3) of the MFMA.
70. Contracts were extended or modified without the approval of a properly delegated official, as required by SCM Regulation 5.

71. Construction contracts were awarded to contractors that did not qualify for the contract, in accordance with Construction Industry Development Board (CIDB) regulations 17 and 25(7A).
72. Construction projects were not always registered with the CIDB, as required by section 22 of the CIDB Act, 2000 (Act No.38 of 2000) (CIDB Act) and CIDB regulation 18.
73. Contracts and quotations were awarded to bidders who did not submit a declaration on whether they are employed by the state or connected to any person employed by the state, as required by SCM regulation 13(c).

#### **Internal control**

74. I considered internal control relevant to my audit of the financial statements, annual performance report and compliance with laws and regulations. The matters reported below under the fundamentals of internal control are limited to the significant deficiencies that resulted in the basis for qualified opinion, the findings on the annual performance report and the findings on compliance with laws and regulations included in this report.

#### **Leadership**

75. Leadership did not fulfil its oversight responsibilities with regards to the implementation and monitoring of internal controls and compliance with laws and regulations and did not insist on daily disciplines to ensure sound financial and performance management and compliance with laws and regulations. This resulted in inaccurate, incomplete and inadequate financial and performance reporting.
76. Several key leadership positions were vacant for part of the financial year and the period of the audit due to political instability and pending forensic investigations. The absence of these top management officials resulted in a lack of effective oversight over financial, performance information and compliance.

#### **Financial and performance management**

77. As reported in the previous year, the municipality did not have sufficient and appropriate daily, weekly and monthly controls over financial statement reporting, performance information and compliance, resulting in year-end processes being onerous and susceptible to material misstatement.
78. Reconciliations and registers were not adequately prepared and reviewed as a result of a lack of financial discipline. This resulted in errors that were not detected during the compiling of the financial statements but rather during the audit process.

#### **Governance**

79. As in previous years, the municipality did not take corrective action and follow up on reports issued by internal audit, resulting in repeat findings in the external audit reports. The effectiveness of the internal audit unit and audit committee is compromised by the lack of action taken by management based on their recommendations.

#### **OTHER REPORTS**

##### **Investigations**

80. Various allegations relating to procurement, appointments and expenditure are being investigated by PWC Incorporated. A draft report was submitted to council at the time of

this report and a follow up investigation relating to the work of a contractor is in progress.

*Auditor-General*

East London

30 November 2013



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